PENSION-BENEFIT PLANS: UNDER PRESSURE

Social Security is not the only defined-benefit retirement program currently facing problems. When older, established companies like the large airlines can no longer afford to pay promised retirement benefits to former employees, the Pension Benefits Guaranty Corporation (PBGC) steps in. With fewer companies paying premiums to the PBGC and more companies handing over their pension liabilities, the PBGC is facing mounting deficits as its revenues fall and liabilities rise.

AGENCY BACKGROUND

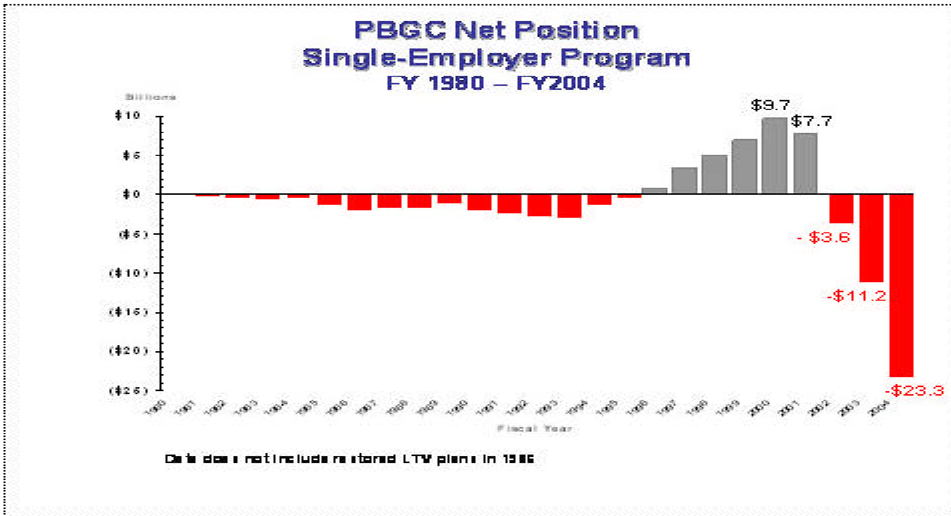
The PBGC insures the pensions of private sector workers participating in defined-benefits plans – pensions that guarantee a fixed amount of money each month. Created by the Employment Retirement Income Security Act (ERISA) in 1974, the government-run corporation does not receive taxpayer dollars. Companies pay a premium of $19 for each employee expected to draw a pension. Plus, if a company's pension plan is underfunded, it must pay an additional $9 for every $1,000 of underfunding.

If a company terminates its pension plan, the PBGC will take over. It guarantees "basic benefits" earned before a plan ended, which include: (1) pension benefits at normal retirement age; (2) most early retirement benefits; (3) disability benefits for disabilities that occurred before the plan was terminated; and (4) certain benefits for survivors of plan participants.

SOLVENCY ISSUES

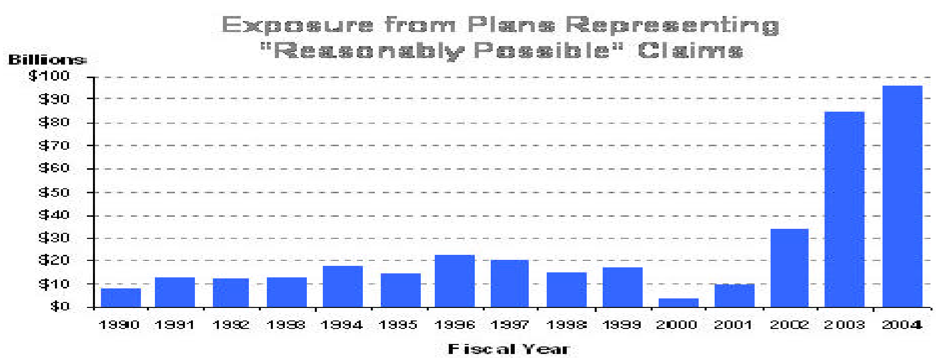
Although the PBGC's assets have increased at a rate of 79 percent between 2001 and 2004, its liabilities, expected liabilities, and payments to beneficiaries have grown at a rate of 345 percent in the same period.

The PBGC's current deficits are mostly the result of assuming the burden of several large defined-benefit plans, including those belonging to Bethlehem Steel, United Airlines and US Airways.



Source: Pension Benefits Guaranty Corporation

The outlook for the PBGC is not promising. To measure its potential future outlays, PBGC calculates its "reasonably expected liabilities." In the last four years its expected liabilities have risen from $11 to $96 billion. The well-known financial problems in the airline industry are primarily responsible for driving up these numbers.



Source: Pension Benefits Guaranty Corporation

While its liabilities are increasing, the PBGC's revenues are declining. Because the PBGC only receives premiums from companies offering defined benefit plans, its revenues have been decreasing in recent years as more employers have begun offering their employees defined contribution plans – like 401(k)s.

A final factor threatening the solvency of the PBGC is that – unlike typical insurance companies – the premiums it charges a company cannot be changed to reflect the likelihood that a certain company will hand over its pension. The PBGC does not distinguish between companies which are financially stable and those which are not, which inherently makes it difficult for the PBGC to adequately cover the risks that it assumes.

ADMINISTRATION PROPOSALS

The Bush administration has proposed reforms to address four areas of the PBGC:

Funding Rules

Proposed reforms would tie pension funding rules to a company's financial health, so that financially sound companies are allowed to fund only their ongoing pension liability, while weak ones are required to fund their entire at-risk liability.

Reforms would also shorten the timeframe in which companies could amortize funding shortfalls to only seven years with no extensions. To encourage companies to fund their pension liabilities beyond the minimum requirement, another proposed reform would increase the tax deduction limit for contributions.

A further reform would preclude companies with poorly funded plans from adopting benefit increases without funding them.

Disclosure

Proposed reforms would make the financial and actuarial information of benefit plans publicly available. In addition, reforms would provide for disclosure of ongoing and at-risk liability, as well as the recent funding status of benefit plans. Safeguards would be put in place to prevent disclosing sensitive corporate information.

Premium Structure

Proposed reforms attempt to ease the PBGC's solvency issues on the revenue side by raising the flat-rate premium of $19 per participant – which has not changed since before 1991 – to $30 per participant, and indexing the fee to future wage growth.

Additionally, the reforms would institute an adjustable risk-based premium for companies with underfunded plans.

Guarantees

The proposal would freeze the PBGC guarantee limit when a company enters bankruptcy. Proposed reforms would also eliminate the guarantee of shutdown benefits, which are promised in employment contracts by companies in the event of a plant or division closure that displaces workers who are too young to retire but too old to start a new job.